Plug those Cash Flow Leaks!

Cash flow has almost nothing to do with Profit!

A business can be profitable and still go bankrupt because of cash flow problems!

Profit is not the amount of money you have available in cash – your cash-flows, and your profit-flows are quite separate. Cash flow is having the right amount of cash in the right places at the right time, every time:

Cash can be sourced in three ways:

- **Share Capital**: investment into the business usually called capital or equity.
- **Borrowings**: from banks, other lending Institutions, or even individuals.
- **Profit**: making profits that generate new cash inflows

In contrast, the only way to make profit is by selling something for more than what it cost to produce; profit is the difference between the amount a business earns and the amount spent in buying, operating, or producing products and services. Profit often begins as cash but during the year is also often used to buy assets such as equipment, machinery, stock or to repay loans. When this happens your profit is no longer cash in the bank but becomes part of the overall value of the business.

*Example*: if you make a bumper number of sales this month, all things being equal you will be more profitable than last month because you have sold more; but if you haven’t yet collected the payments for those sales, even though your books will show a lovely profit, your cash flow may well be terrible because you are still waiting for people to pay. To make it worse you probably have already paid for your stock and staff as you were making the sales.
As the example illustrates cash flow is impacted by many different aspects of your business – so great cash flow means mastering more than just one thing! Cash flow can be impacted by your:

* Staff
* Systems
* Processes and Terms
* Customers
* Suppliers and Inventory Levels
* Financiers

Firstly make sure you are solvent: Can you pay your bills as they fall due?

If you are not able to pay your bills within their terms then you are insolvent trading this is illegal in most countries. Cash flow is the main trigger of business failures so it is critical to ensure you have sufficient cash at all times, or face the harsh reality that perhaps you need to “shut up shop”. As long as you are still afloat then targeting your cash flow is easy!

To plug cash flow leaks, start by asking these six simple questions:

1. **Systems**
   Do you know exactly who owes you money and when it is due (and overdue)?
   **Why this is important:** Slower Debtors means more cash is locked-up so you can’t use it to pay your own bills and staff; this is usually the biggest contributor to bad cash flow. Debtors paying sooner will create a faster flow of cash so you can reduce your borrowings, or fund growth more easily.
   **What you can change:** From point of contact, right through to debt collection you are sending messages about how important your cash flow is. Accept payment via as many channels as possible, ensure you have eftpos, take credit cards, cash, cheques etc. Plus, keeping your accounting system up to date with both invoices raised and payments received avoids chasing (and annoying) customers who have already paid.

2. **Customers**
   Will your debtors continue to pay at the same pace (Faster or Slower)?
   **Why this is important:** Slower Debtors means more cash is locked-up so you can’t use it to pay your own bills and staff; this is usually the biggest contributor to bad cash flow. Debtors paying sooner will create a faster flow of cash so you can reduce your borrowings, or fund growth more easily.
   **What you can change:** Choose your customers carefully – and be very clear about what you expect. Don’t be afraid to walk away it is better to have no customers and spend your time building a good pipeline of excellent new customers than DONATING your efforts for non-customers who WILL NEVER PAY!!
   Unfortunately late payers are common and chasing them is not fun! [Collect Debtors Sooner](#).
3. Finances

Will you stay within your Overdraft Limit for the coming year?

**Why this is important:** Changing your bank finance is time-consuming, lengthy and risky – if you apply for more finance when you are in a weak cash flow position, the bank is not only likely to say **NO** but may also try to reduce the loans you currently have (or increase your interest rates)

**What you can change:** Good forecasting of cash needs and good decisions to stay within your cash capabilities. The easiest way to do this is to have a budget, ensure you use that to create a cash forecast and carefully monitor how you are progressing against what you predicted. Even for a tiny business creating these tools is vital to both manage cash flow well and to help secure finance if it is needed.

Before you do watch out for pitfalls – and check out [Quick Cash Flow Fixes can bring problems too!](#).

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4. Processes and Terms

Are your Internal workings creating issues?

**Why this is important:** If you don’t know about and support your own cash flow why would anyone else care? Without clear payment rules, and you sticking to and enforcing these rules, customers will put their own cash flow first by letting amounts overdue to you stay that way!

**What you can change:** Create and enforce very clear payment rules in your terms and conditions, AND ensure you follow up in accordance with your own process. This blog article has more tips [Better Invoices get paid quicker!](#).

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5. Suppliers and Inventory

Do you actively control your cash outflows?

**Why this is important:** This impacts your cash flow in much the same way as Slow Debtors; Having to outlay your cash early or keeping loads of Inventory both eat up cash. Deferring payments and minimising stock will create a slower flow of cash out the door so you can reduce your borrowings, or fund growth more easily.

**What you can change:** Negotiating the best terms possible with your suppliers is a good start. At the very minimum ensure your terms of payment to your suppliers match your terms of payment from your customers – so you align your expected receipts from sales with your expected outlays. Also look at how you can reduce stock and inventory – for example “Just in Time” ordering processes will both reduce your stock and your storage costs (but watch out it may also come with short payment terms).
6. Staff

Are your staff mindful of your Cash flows?

Why this is important: Payroll is usually one of the largest cash requirements – so aligning your staff incentives and behaviours to good cash flow is a great way to improve overall cash flow of the business.

What you can change: From using commissions for ‘Payment on time’ as well as ‘Sales Made’ to motivate your sales people; to linking Quality to bonuses for production staff; and having bonuses for your most effective Debt Collection Staff incentives – these all send a clear message about your priorities. Also to ensure your staff levels and pay rates are appropriate check out the post – Start with Labour when Reducing Costs!

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READ THIS FREE CHECKLIST

How many ways can you improve your cash flow? The answer is 48!

Fill in the form and download your 48 ways right now!

For more information click here.

Your Information is 100% Secure And Will Never Be Shared With Anyone.

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About Eve Blackall

I really appreciate that you are reading my post; I regularly write to help SME owners discover hidden profits, cash and value in your business.

If you would like to read my regular posts you are welcome to follow my blog on Facebook and Twitter, or subscribe to my six weekly blog roundup newsletter.

Eve Blackall is a ‘business fixer’. Using her Profitology, Cashflowology and Exitology frameworks, she solves the two biggest financial challenges of any business: making more money, and keeping more money.

Having been a Group Financial Controller for several top 100 ASX listed firms, in addition to operating her own highly lucrative accounting practice, Eve is the author of ‘Profit-ology’ the ultimate guidebook, anyone can use, to increase their profits.

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